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Pre-packaged reorganisations in China and creditor protection

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Introduction

Pre-packaged reorganisation (hereafter pre-packs), as one form of insolvency practical innovation originating from the US and UK, have recently gained popularity in China in the shadow of Chinese Enterprises insolvency law 2006 (hereafter CEIL). This article will examine the features and main uses of Chinese pre-packs under the CEIL. The author argues that Chinese pre-packs are in a modest and traditional form as pre-insolvency creditors' voting on the proposed reorganisation plans is generally required. This article also evaluates the benefits and drawbacks of Chinese pre-packs and argues that the unclear rules of Chinese pre-packs may do more harm than good to creditors. It suggests that market and insolvency practitioners should replace administrative intervention for a better creditor protection.

1 Introduction of pre-packs

The main purpose of insolvency reorganisation or administration proceedings is arguable to preserve the going concern value of distressed companies for creditors.¹ When a distressed company with valuable going concern value goes to court for help, it may be frustrated by the protracted and costly reorganisation proceedings, which in turn frustrates the purpose of reorganisation proceedings. As the value of that company may be melting away quickly, ideally, it will find buyers who can purchase the whole or part of the business and then use reorganisation proceedings to implement this deal. The benefits can be: reduced pressure to find adequate sources of refinancing to support the protracted full administration proceedings; preventing damage to goodwill once the formal insolvency proceedings are opened; retaining the key employees who are averse to insolvency.²

This demand is the catalyst that gives birth to the pre-packaged reorganisations. In the UK, pre-pack administrations frequently refer to the practices where the negotiation of sale of

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¹ Going-concern value is the value of a company as an ongoing entity. See also DG. Baird, 'Bankruptcy's Uncontested Axioms' (1998-1999) 108 Yale L.J. 573 p577

² R. Parry, *Corporate rescue* (Thomson Sweet & Maxwell 2008) p16

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almost all business or assets of the distressed companies is arranged before the appointment of administrators and the opening of administration proceedings.³One feature is that the proposed sales of debtors' business do not need to get unsecured creditors' approval.⁴ A quintessential pre-pack allows a debtor and buyers to negotiate the terms of sale of the distressed businesses and execute the sale immediately after the opening of administration proceedings.⁵

In the UK, unsecured creditors are the only creditors allowed to vote on the administrators' plan, while one caveat is that administrators can skip the creditors' meetings if they are sure no value will break down into the unsecured creditors' class.⁶If the company cannot be saved as a going concern for the benefit of general creditors, the administrator may not commence the creditors' meeting.⁷However, in practice, even if the administrator believes that there may be interests for unsecured creditors in some cases, he can still use his power to sell the assets of the company.⁸This power has been affirmed by the case *Re Trans Bus International Ltd.*⁹Such efficiency comes from the fact that the Enterprise act 2002 aims to reduce the courts' involvement in cases where the meetings of creditors are unnecessary; without such new rules, administrators cannot make any decisions during the period of administration without the approval of courts.¹⁰

In the US, traditional pre-packs refer to the reorganisation practices where the negotiations of reorganisation plans, disclosure statements and creditors' acceptance are all obtained before filing Chapter 11 reorganisation proceedings.¹¹However, contract-based negotiations may require unanimous agreements to be achieved.¹²Without the help of bankruptcy tools such as

³ M. Hyde and I. White, 'Pre-pack administrations: unwrapped' (2009) *Law and Financial Markets Review* 3(2) p134

⁴ *ibid* p262

⁵ A. Goldrein, Unwrapping English pre-packaged administrations: a guide to "pre-packs" 7 *Pratt's J. Bankr. L.* 444 2011 p445; P. Walton, 'Pre-packin' in the UK' (2009) *Int. Insolv. Rev.*, Vol.18 p86

⁶ J. Armour, 'The rise of the 'pre-pack': corporate restructuring in the UK and proposals for reform' *Restructuring Companies in Troubled Times: Director and Creditor Perspectives* (2012) p6; *Insolvency Act 1986* Sch. B1 para. 59(1)

⁷ *Insolvency Act 1986* B1 para. 52(1)

⁸ P. Walton, 'Pre-packin' in the UK' (2009) *Int. Insolv. Rev.*, Vol.18(85) 108 p90

⁹ *Re Transbus International Ltd* [2004] EWHC 932 (Ch) Chancery Division

¹⁰ *ibid.*

¹¹ MD Plevin, et al, 'Pre-packaged Asbestos Bankruptcies: a flawed solution' 44 *S. Tex. L. Rev.* 883 2002-2003 P888

¹² V. Finch, *Corporate insolvency law perspectives and principles* (Second edition Cambridge university press 2009) p253

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cram-down, pre-packs may be vulnerable to the holdout issue from creditors. This is especially true when the creditors and categories of debts are fragmented.¹³ The more creditors are involved, the more difficult it is for private negotiations.¹⁴ This makes the traditional form of pre-packs difficult to achieve the benefits that pre-packs aim to achieve.

As a result, another relatively radical variant of pre-pack appears under US bankruptcy code 363(b): after a notice and hearing, the debtor in possession has the power to sell all its assets without meeting other requirements of confirmation of a normal chapter 11 plan.¹⁵ Strictly speaking, provision 363(b) is not part of Chapter 11 so that it may not be qualified as an independent reorganisation proceeding. But the US 363(b) sale and the UK type of pre-pack sale are far more popular than traditional forms of pre-packs under the US definition. This is to a large part, due to their fast solutions to the 'melting businesses' on the one side and their ability to transfer value from unsecured creditors to senior creditors or debtors on the other side.

The downside of 363(b) sale and UK pre-packs is clear. Due to the opaque pre-negotiation of deals between debtors and insider buyers, the unsecured creditors in a given pre-pack sale are most likely to be the victims in that administrators may skip notice to them or approval from them.¹⁶ Where the assets are sold to the existing management team, such pre-pack may be dubious to unsecured creditors as it is very likely that only the senior creditors are paid off in exchange for further finance support to the Newco established by the existing teams while leaving nothing to unsecured creditors.¹⁷ As a result, pre-pack sales may be rigged by the senior creditors and it may not necessarily maximise the value of the distressed groups of companies.¹⁸ Even though pre-pack may reduce the cost of long and complex administration fees, the price sold may be significantly lower in comparison to the value of one business

¹³DG. Baird and RK. Rasmussen, 'Anti-bankruptcy' The Yale Law Journal, Vol. 119, No. 4 (2010) p652

¹⁴JB. Johnston, 'The Bankruptcy Bargain' 65 Am. Bankr. L.J. 213 (1991) p231

¹⁵EB. Rose, 'Chocolate, flowers and § 363(B): the opportunity for sweetheart deals without chapter 11 protections' (2006) 23 Emory Bankr. Dev. J. 249 p249

¹⁶P. Walton, 'Pre-packing' in the UK' (2009) Int. Insolv. Rev., Vol.18 85 p87

¹⁷G. McCormack, *Corporate rescue law--an Anglo-American perspective*, (Edward Elgar Publishing Limited UK 2008) p72

¹⁸S. Frisby, 'Report to The Association of Business Recovery Professionals, a preliminary analysis of pre-packaged administrations' August 2007 p50, p56; LM. Lopucki and JW. Doherty 'Bankruptcy fire sales' (2007) UCLA School of Law, Law & Economics Research Paper Series Research Paper No. 07-07 p35

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after reorganisation (only the latter's 50%).¹⁹ Arguably, one assertion could be made that at least pre-pack may not significantly increase the overall return to all the creditors, but it is suspected of transferring wealth from the preferential and unsecured creditors to secured creditors.²⁰ Secured creditors, existing management teams and professional advisors have the inclination to use a pre-pack sale as they can benefit most from it.²¹

2. The development of pre-packs under CEIL 2006

2.1 Pre-packs under CEIL 2006

As with pre-packs in the UK and US, CEIL 2006 does not formally introduce pre-packs as an independent insolvency proceeding for distressed companies. By the same token, pre-packs appear in Chinese insolvency practice as a result of innovative interpretation of provisions under CEIL. In China, it is generally believed that UK pre-packs and US 363(b) sale are reorganisation proceedings aiming to conduct a sale of business, while only the traditional form of US pre-packs that require soliciting creditors' voting is named as pre-packs. The reality is that reorganisation plans in China can never sidestep creditors' voting and courts' approval.

Though administrators have the power to sell most of the assets or transfer business to a third party during the reorganisation proceedings, they need to report to creditors committee or courts.²² Administrators have no power to sell debtor's business out of the ordinary course of business without the approval of creditors' meeting.²³ Also, CEIL has no intention to allow a sale of the business to 'sneak' out of the protections offered by reorganisation proceedings; sale of businesses needs to be approved by creditors' meetings and courts at all circumstances.²⁴

¹⁹ See LM. Lopucki, JW. Doherty 'Bankruptcy fire sales' (2007) UCLA School of Law, Law & Economics Research Paper Series Research Paper No. 07-07 p3

²⁰ V. Finch, *Corporate insolvency law perspectives and principles* (Second Edition Cambridge university press 2009) p463

²¹ G. McCormack, *Corporate rescue law--an Anglo-American perspective*, (Edward Elgar Publishing Limited UK 2008), p73

²² Chinese Enterprise Insolvency Law Art.69

²³ CY. Han, 'A discussion of assets disposal in insolvency procedures-based on Jianghu-Eco reorganisation case' *Politics and law* 2011 12 p83

²⁴ YG. Xu and WH. He, 'A research on the judicial application issues of business sale type of reorganisations—based on a comparison of cases in China and US.' (2017) 4 *Journal of law application*

However, it is generally believed that CEIL 2006 tolerates the traditional form of pre-packs which require creditors' approval before the opening of reorganisation proceedings. The reasoning is that the CEIL 2006 does not require that the negotiation of reorganisation plans and the solicitation of creditors' votes on the plans have to be conducted after the opening of reorganisation proceedings.²⁵ As a result, pre-packs in China take a modest form which is similar to traditional US pre-packs as above mentioned. This requirement may offer better protection for creditors.

From the perspective of administrators, CEIL is also ill-designed for a UK type of pre-packs. One empirical study of UK pre-pack indicates that in about 70 percent of the pre-pack deals, administrators are appointed out of court by creditors.²⁶ The administrators appointed may be the ones favoured by the senior creditors. Since administrators could be appointed by floating charge creditors in an out-of-court fashion, they are exposed to the relevant deals information from the beginning and confident to execute the sale plan later in the formal proceedings. The US DIPs also enjoy the same level of information advantages and control of debtors' businesses.

CEIL avails itself of both DIP and manager-replacing regimes. In practice, about 80 percent of cases, the courts appointed administrators as opposed to DIPs.²⁷ In pre-packs, Chinese courts can also appoint administrators before the opening the reorganisation proceedings.²⁸ Unlike the privilege enjoyed by certain creditors in the UK, administrators in China can only be appointed by courts.²⁹ More importantly, CEIL not only allows professional insolvency practitioners to hold the office of administrators but also permits government officers to form what it calls 'liquidation committee.' The liquidation committee, consists of members of the government, play the same role as insolvency practitioners. Senior creditors have no incentive to initiate reorganisation proceedings as they cannot appoint their favoured

²⁵ Zhejiang Hangzhou Yuhang District people's Court Research Group, 'Exploration and recommendation to the pre-packs of real estate companies' The people's Judicature P15-16; HJ. Dong, 'Policy of business reorganisation in China and the turnkey solution' Modern law science (2005) 31(5) p38

²⁶ S. Frisby, 'A preliminary analysis of pre-packaged Administrations-Report to The Association of Business Recovery Professionals' 2007 p20

²⁷ Y. Ding, 'Improvements of the implement of listed companies' reorganisation plans-based on Chinese listed companies data analysis' politics and law 2014 9 p143

²⁸ Insolalerts, 'Seven exemplary insolvency cases from Shenzhen intermediate people's court' (2017)

²⁹ Chinese Enterprise Insolvency Law Art.22

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insolvency practitioners. On the contrary, senior creditors may worry about the appointment of 'liquidation committee' in the sense that it may take sides with state-run debtors or other connected shareholders at the cost of creditors. On the side of debtors, as no default rules guarantee that the managers can still occupy the offices as DIPs, they may have no strong incentive to start pre-packs as well.

2.2 Main uses of Chinese pre-packs

Chinese pre-packs give courts an early entry into the prospective insolvency cases. When a reorganisation petition has been filed by creditors or debtors before the court decides to accept the case, it may start to build up a communication platform and glean information; it may also convene a meeting with all relevant parties and facilitate the drafting of a preliminary reorganisation plan and arrange creditors' voting. The result of the voting sometimes counts so that there is no need to have another voting after courts agree to commence the reorganisation proceedings later.³⁰

One recent pre-pack case is China National Erzhong Group reorganisation case. China national Erzhong is a state-owned company which specialises in manufacturing heavy machines. In 2014, its bank debts exceeded 2 billion pounds which led the company to be balance sheet insolvent. Under the aegis of state-owned Assets Supervision and Administration Commission, the company's nearly 30 financial institutional creditors formed creditors' committee and started out-of-court negotiation. Under the coordination of China Banking Regulatory Commission, financial institutional creditors reached a reorganisation plan and it was approved by Deyang Intermediate court.

Another application of pre-packs is for the reorganisation of Chinese listed companies. In China, the identity and status of listed companies are very valuable as all companies aiming to become listed companies need to go through the checking and acquire the approval from China Securities Regulatory Commission (CSRC). That is to say, the 'shells' of listed companies are rare resources that many other private companies covet. The result is that a

³⁰ HT. An, 'Xiamen Pre-pack case-saving a distressed companies' People's Court Newspaper. (2016) 006.p1

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distressed listed company, irrespective of having going concern value or not, can simply sell its shell via a sale of shares to other private companies so that the latter could obtain the valuable status as being a listed company. This type of reverse takeover is named as 'assets reorganisation' in China as the private companies aim to pour their own business into the shells of distressed debtor companies bought from the secondary market.

Potential buyers of insolvent listed companies generally conduct assets reorganisation after a debt reorganisation. The purpose is to convert distressed companies to empty shells without debts or reduced debts as the investors are not interested in buying debtors' business and debts. Debt reorganisation plans may frequently involve debt-to-share swaps, buying or selling assets or shares, issuing new shares or bonds. These transactions may also be subject to the investigation and approval of CSRC.³¹ The problem is all these transactions may lead debtor companies to empty shells without feasible business, CSRC may forbid these manoeuvres.³² Also, without asset reorganisation, the debt reorganisation plans are not feasible if they only result in a shell company without business. Therefore, the court will not approve the reorganisation plans either.³³

The conflict is that CEIL endows courts the power to sanction the reorganisation plans without mentioning the role of CSRC.³⁴ This conflict may lead to undesirable results in that courts may not be able to give effect to proposed and voted reorganisation plans independently.³⁵ It has been realised that the whole process of the rescue of listed companies will be improved if the so called assets reorganisation and debt reorganisation can be integrated together.³⁶

The solution for such issue entails well-organised communication and cooperation between CSRC and courts.³⁷ It is here that pre-packs can play an important role as they provide an

³¹ XX. Wang and JH. Li, 'A quest of the relationship between administrative power and judicial power in insolvency,' *Politics and law* (2008) 9 p3;

³² Listed companies' material asset reorganisations rules 2016 Art.11(2) and (5)

³³ CEIL 2006 art.87(6)

³⁴ XX. Wang and YG. Xu, 'A research on legal systems for reconstruction of listed company' (2007) *China Academic Journal* 3 p68-69

³⁵ YN. Zhang, 'Some thoughts on improvement of Chinese reorganisation institution' *Politics and law* 2015 2 p13

³⁶ Y. Ding, 'Improvements of the implement of listed companies' reorganisation plans-based on Chinese listed companies data analysis' *politics and law* (2014) 9 p150

³⁷ China Supreme Courts' notice –In re the gist of meeting with regard to reorganisation cases of listed companies (29/10/2012 No.261)

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early platform for all relevant parties to negotiate and exchange of information. At the stage of pre-packs, debtors, creditors and investors can negotiate together and conclude reorganisation plans which not only meet the CSRC's requirements but also comply with insolvency law.³⁸ By considering the assets reorganisation and debt reorganisation, if the CSRC and the courts may all support the whole process, the investors and creditors will be more assured to proceed to complete the deals.

One example is the recent reorganisation of Sainty-Marine ship manufacturer. The insolvent company would be delisted if it could not be reorganised in one year. One challenge is the conflict of conflicts of administrative power and judicial power. The Supreme people's court of China and CSRC collectively held a meeting; the court agreed that the approval of debt reorganisation plans should be sanctioned after hearing the CSRC's decision on asset reorganisation.³⁹

3. An evaluation of Chinese pre-packs with regard to creditors' protection

In the UK and US, pre-packaged reorganisations are controversial as they can be controlled and abused by the existing management teams or senior creditors of distressed companies. Due to inadequate information disclosure and a lack of systematic protections offered by the reorganisation proceedings, some deals are said to be 'sweetheart' deals which only aim to redistribute wealth from unsecured creditors to senior creditors or to insiders such as existing management teams.⁴⁰ It is susceptible in the cases where the senior creditors appoint their favoured administrators or exert control through refinancing contracts. The undesirable result would be a low price for the business sold.

As pre-packs can be abused, therefore, there should be sound business reasons⁴¹ to justify the use of them. For example, the uses of pre-packs may be supported by evidence of best price

³⁸ ZF. Wang, 'Pre-packs and their effect on listed companies rescue' Securities law Garden (2010) 3 596 P603

³⁹ See 'Simultaneously conduct assets reorganisation and debt reorganisation-the reorganisation plan of Sainty-Marine is approved by court' at People.cn <http://js.people.com.cn/n2/2016/1109/c360301-29282386.html> visited at Feb (2017)

⁴⁰ See generally EB. Rose, 'Chocolate, flowers and § 363(B): the opportunity for sweetheart deals without chapter 11 protections' (2006) 23 Emory Bankr. Dev. J. 249

⁴¹ MP. Goren, 'Chip Away at the Stone: The Validity of Pre-Bankruptcy Clauses Contracting

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or 'value-melting' assets. In China, there are no well-developed principles about the threshold of use of pre-packs. Reorganisation proceedings can be triggered by either debtors or creditors.⁴² Under some circumstances, when the creditors or debtors apply to courts for reorganisation proceedings, the reason that the courts decide to use pre-packs is because debtors are not able to design reorganisation plans and the courts may believe that government/courts' early intervention and coordination of all relevant parties by such intervention are necessary prior to reorganisation proceedings.⁴³

This reason to use pre-packs may not be always sound. One essential feature of pre-packs is that debtors can provide negotiated reorganisation plans and disclosure statements at the same of filing reorganisation proceedings.⁴⁴ If debtors with information advantages have no ideas about the possible sustainable reorganisation plans and potential buyers, rarely the courts without information can make sound judgments on issues of this kind. More likely, this messy situation may indicate that the companies may have no going concern value to be released via reorganisation proceedings and the correct path for the companies should be liquidation. Even though some plans may be finally reached by parties, the effect of such intervention, in fact, may be counter-productive as it forces creditors to reach compromises and may destroy the nature of private negotiations at the pre-packs stage before reorganisation proceedings.

Chinese pre-packs also face the similar transparency issue. From the experience of UK, the Statement of Insolvency Practice 16 requires administrators to disclose their background of their appointment; to provide explanation to unsecured creditors regarding the justifications of pre-pack sales; to answer why pre-pack sales are the best results for all creditors.⁴⁵ Nevertheless, Chinese courts struggle at this stage as the current CEIL contains no clear standard of information disclosure for the purpose of the reorganisation plan and voting,

Around Section 363 of the Bankruptcy Code⁵¹ N. Y. L. Sch. L. Rev. 1077 (2006-2007) p1083

⁴² CEIL 2006 article 7

⁴³ Zhejiang Hangzhou Yuhang District people's court research group, 'Exploration and recommendation to the pre-packs of real estate companies' The people's Judicature p17

⁴⁴ MD. Plevin et al, 'Pre-packaged Asbestos Bankruptcies: a flawed solution' 44 S. Tex. L. Rev. 883 (2002-2003)p888

⁴⁵ B. Xie, 'Protecting the interests of general unsecured creditors in pre-packs: the implication and implementation of SIP 16' (2010) Company lawyer p6

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never mind pre-packs.⁴⁶ As a result, neither the disclosure standard of the administrators' background and the disclosure of the terms of the deals are clear.

In the cases where the voting of creditors is sought, the efficacy of Chinese pre-packs can be doubted in that it is difficult to shorten the length of the whole negotiation process compared to ordinary reorganisation proceedings. What the pre-packs offer is nothing more than shifting what need to do in reorganisation proceedings before the opening of reorganisation proceedings. The problem is, if pre-packs are only commenced after receiving of reorganisation petitions, the stigma of insolvency has already attached to the distressed companies and it may be too late to rescue the business. Also, arguably, the most time-consuming part of reorganisation is the negotiation of reorganisation plans and obtaining all parties' approval. If this section cannot be skipped, it is not quite convincing how the time and professionals' fees can be reasonably reduced and how the length of this process can be shortened.

One interesting point is that Chinese pre-packs cases actually wrap up quickly.⁴⁷ There may be two postulations to explain this 'desirable speed'. One explanation of the fast speed of Chinese pre-packs is to credit the courts or governments with their effort of coordination. This especially true in the cases where debtors and even senior creditors are state-run parties. Given the fact that most of the listed companies in the main stock market are state-run companies,⁴⁸ that many institutional banks are also state-run, it seems government and courts can act as coordinators similar to the role that the Bank of England plays in the London Approach restructuring. The government and courts may maintain a great discipline of those state-run lenders and debtors to supporting the reorganisation on behalf of all relevant parties.

It is also worth mentioning that the imperfect Chinese capital market and legal environment to some extent justify some degree of administrative intervention. Due to inadequate of

⁴⁶ ZF. Wang, 'An economic and legal analysis of pre-pack institution' *Tribune of Political Science and Law* (2009) 27(2)P112

⁴⁷ For example, in China National Erzong Group reorganisation case, it only lasted for 80 days from filing reorganisation petition to court approval of the reorganisation plan.

⁴⁸ YS. Li, 'A study on the listed company's scheme of bankruptcy reorganisation' (2011) *Southwest University of political science and law* p33

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redundant employees' protection mechanisms, workers who are laid off will cause the instability of the society.⁴⁹ Also, due to a lack of investors' protection mechanisms, individual investors, sometimes even institutional investors, fall victims of fraud and informational asymmetry.⁵⁰ As a result, considering that many above-mentioned complement mechanisms are lacking, one may argue that the coordination and intervention provided by courts or even government contribute to the low costs and the fast speed of Chinese pre-packs. However, it is predictable that these benefits will fade away quickly as China is increasingly embracing market rules and improving its legal environment.

Another possible answer to the fast pre-packs process is that the courts and administrative power may 'force' creditors to accept the plans.⁵¹ Chinese pre-packs provide courts with an early involvement in the cases as they may decide to use pre-packs in certain cases when reorganisation petitions are filed. Courts may thereafter supervise the disclosure of information and organise creditors' meeting and voting for the preliminary reorganisation plans. Without clear rules prior to insolvency proceedings, it is unclear how the courts can facilitate the private negotiations of the deals and what guidelines the courts should observe. This is especially an issue in the cases where the government plays a dominant role in reorganisations. They may help to coordinate with other parties, while their administrative power may also distort the orderly running of insolvency law. When it comes to creditors' protection, one may argue that the uncertainty and abuse caused by courts or government at the pre-packs stage may counterbalance all the protections offered by the voting requirement.

Due to the requirement for approval of creditors and courts, senior creditors' control in pre-packs may not be insomuch as a concern in China as it is in the UK and US. Nevertheless, concern may arise if the role of the government and the courts in pre-packs is oblique and unchecked. From the intervention of the delisting of companies⁵² to the reorganisation

⁴⁹ *ibid* p32

⁵⁰ For example, in the case of fraud, listed companies will only be charged a small amount of fines which cannot form deterrent to further wrongdoings. Also, there is no class action regime to protect investors in China.

⁵¹ Generally speaking, shareholders' interests are preserved better than unsecured creditors in Chinese listed companies' reorganisation cases; the courts subject to administrative power may cram down and approve the reorganisation plans as such. Ding Yan, 'Distortion and rectification of administrative power in the reorganisation cases of listed companies-based on 45 listed companies' reorganisation cases' Legal forum (2016) 3 p125

⁵² H. Zhai, 'Delisting of Listed Companies: Theoretical Analysis and System Construction' (2012) Doctorate thesis P69

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proceedings, the local governments or the government-supported shareholders may control the reorganisation proceedings and force the reorganisation to be done within tight timeframe at the costs of creditors.⁵³In some cases, for the purpose of preserving the 'shells' of listed companies, government and courts may force creditors to accept the reorganisation plans which allow shareholders to keep a large percentage of their shares; the contravention of absolute priority doctrine and the increase of shares' value after reorganisation gave previous shareholders a fortune at the cost of creditors.⁵⁴

It is also unclear whether the mechanisms of creditors' protection provided by reorganisation proceedings can be compromised in pre-packs. Since CEIL insists creditors and courts' approval of the deals, it implies that pre-packaged deals are not essentially different from deals through reorganisation plans. Drawing on US Chapter 11, CEIL adopts similar doctrines of best interest⁵⁵ and feasibility of reorganisation plans to confirm reorganisation plans and adopts absolute priority⁵⁶ and unfair discrimination (*pari passu*) to cram down general creditors.⁵⁷However, in practice, shareholders or government have strong incentives to opt for sweetheart deals; after reorganisations, given that the distressed listed companies may go back to the capital market and value of shares may surge, previous shareholders are reluctant to give up their interests to creditors at pre-packs negotiation stage. For example, it has been recognised that absolute priority principle does not apply to shareholders of listed companies in practice, as shareholders frequently keep a disproportionate percentage of value in reorganisation before creditors are fully paid.⁵⁸The unbalanced power makes the above insolvency principles and doctrines difficult to implement.

All these arguments do not try to deny the good intention of government and courts in many cases. Rather, it mainly aims to point out that intervention on the basis of unclear principles

⁵³ ZF. Wang, 'An economic and legal analysis of pre-pack institution' Tribune of Political Science and Law (2009) 27(2) p110

⁵⁴ F. Li et al, 'Creditors' protection in reorganisation proceedings-examples from two listed companies'(2013) 10 Jingguanyanjiu p3

⁵⁵ Any creditors should receive a minimum interest not lower than that they would have received, had the liquidation proceedings been opened.

⁵⁶ Any parties who are ranked lower than the objecting class of creditors can receive any payment before the objecting class is fully paid.

⁵⁷ CEIL 2006 Article 87.

⁵⁸ XX. Wang and YX. Song, 'A research on legal issues of cram-down of reorganisation plans'(2014) Hanjiang Forum p122

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and rules may distort creditors' expectation and make creditors incur losses. As it is difficult or impracticable to hold government accountable in reorganisation cases, their imprudence and unprofessional practice may throw a wrench on the reorganisation rules and may cause a counter-productive effect.⁵⁹ Their intervention may also slow down the process of establishment and development of a professional team of insolvency practitioners. Therefore, the conduct of government and courts in Chinese pre-packs should be curbed and their roles should be confined to coordinators in the cases where they may truly provide necessary support to insolvency practitioners.

4. Conclusion

This article introduces the recent development of pre-pack reorganisation in China under CEIL 2006. It provides that the Chinese pre-packs are in a modest form in the sense that it still requires debtors to solicit all or part of creditors' acceptance or hold a preliminary voting prior to the opening of administration proceedings. Unlike UK pre-pack or US pre-negotiated 363(b) sale, Chinese equivalent may avoid a radical transfer of wealth from unsecured creditors to secured creditors. Also, pre-packs seem to be a possible path for the reorganisation of listed companies. However, administrative intervention and courts' active role in pre-packs may harm creditors' expectation and interests. In the long run, China should follow market-driven rules and professional insolvency practitioners should largely replace the administrative intervention to providing a better protection to creditors.

⁵⁹ This is especially true when the government officers are appointed as insolvency trustees. See XX. Wang, 'Liquidation committee as insolvency trustees' Lesson 10 China insolvency law Forum. 2017